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SUBJECT: AUSTRIA'S 2007/2008 OUTLOOK - DYNAMIC GROWTH

REFS: A) 06 VIENNA 3591; B) 06 VIENNA 3043

Summary

1. Austria's GDP grew at a better than expected rate of 3.3% in 2006, its highest growth rate since 2000. For 2007, Austria's two leading Austrian economic institutes have upgraded their growth forecasts to 2.6-2.7% on the basis of strong exports, robust investments, recovering private consumption, and benefits from strong growth in Eastern and Southeastern Europe. For 2008, growth rates should dip to 2.3-2.4%. However, for both years, the Austrian growth rate will be higher than average growth in the Euro area. The unemployment rate should decline from 4.9% in 2006 to about 4.5-4.6% in 2007/2008, despite an increasing labor supply. Inflation will remain low at 1.5-1.7%. Economists regard the total public sector deficit of 1.2% in 2006 as too high for the current cycle of strong economic growth. End Summary.

2006 Better Than Expected

2. The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) recently presented revised growth projections for 2006. Both institutes noted that the 2006 growth rate of 3.3%, the best GDP numbers since 2000, was much better than expected. The continued export boom sparked a robust investment cycle, with private consumption steadily improving as a result of rising employment and moderately rising incomes.

3. The institutes also presented a slightly upgraded forecast for 2007 and an initial forecast for 2008. The institutes upgraded their 2007 forecasts by a quarter of a percentage point to 2.6-2.7%, based on the Austrian economy's strong dynamics spilling over from 2006 and entrepreneurs' optimistic production expectations. As in 2006, the generally improving economic situation in Europe, strong exports, robust investments and a recovery of private consumption will drive the economy in 2007. However, in 2007, the German VAT increase will have a negative impact on Austrian growth.

4. Initial projections for 2008 are for slightly lower growth of 2.3-2.4% due to the expected slowdown in European economic growth. In both 2007 and 2008, economic growth in Austria will be about a quarter of a percentage point higher than average growth in the Euro area. Austria will also benefit more than other EU Member States from the accession of Bulgaria and Romania.

## Assumptions for Growth Forecasts

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¶15. The institutes based their revised 2007/2008 forecasts on the following assumptions:

- U.S. economic growth of 2.3-2.8% in 2007 and 2.8-3.0% in 2008;
- Euro area growth of 2.3-2.4% in 2007 and 2.0-2.1% in 2008;
- EU-25 growth of 2.3-2.5% in 2007 and 2.0-2.2% in 2008;
- German growth of 1.8-1.9% in 2007 and 1.7-1.8% in 2008;
- oil prices of \$60-69 per barrel in 2007 and \$61-69 in 2008; and
- dollar/Euro exchange rates of 0.74-0.77 in 2007 and 0.70-0.77 in ¶2008.

## Other Forecasts Share the Optimism

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¶16. The WIFO and IHS forecasts track with those of other institutions. The December 2006 Austrian National Bank forecasts project growth rates of 2.8% in 2007 and 2.4% in 2008 for Austria. The OECD's November 2006 Economic Outlook predicts growth of 2.5% in 2007 and 2.4% in 2008. The IMF's September World Economic Outlook foresees 2007 and 2008 growth at 2.8% and 2.3%, respectively. The European Commission's Autumn 2006 Economic Forecast predicts 2007 growth at 2.6% and 2008 at 2.1%.

## Unemployment Down, But Labor Supply Increasing

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¶17. Strong economic growth has started to have a positive effect on the labor market, with the creation of 57,500 jobs in 2006. This translates into employment growth of 1.5%, the highest since the

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early 1990s. However, the unemployment rate eased only slightly from 5.2% in 2005 to 4.9% in 2006. The sluggish downward movement of the unemployment rate, despite strong economic growth, is due to a steady increase in the labor supply. Demographic trends indicate declining growth in the labor force over the next years. However, increased immigration, industrial restructuring, productivity gains, efforts to raise labor participation of women and older employees, the gradual phase-out of early retirement, and government efforts to reduce civil service employment will provide for sufficient labor supply over the medium-term. Projected GDP growth in 2007 should help to cut the unemployment rate down to 4.6%, but slower growth in 2008 will be too low for further improvement.

## Inflation Remains Low

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¶18. Inflation will remain low at 1.5-1.7% in 2007/2008. Increases in oil price in the last several years have had little secondary effects on the Austrian economy. The recent easing of oil prices, a stronger Euro, and increasing imports of less expensive industrial goods have had a dampening effect on inflation.

## Public Finances

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¶19. Stronger than expected economic growth has yielded higher tax revenues, particularly higher corporate tax revenues. Both institutes now project the 2006 total public sector deficit at 1.2% of GDP, compared to a budget deficit of 1.5% in 2005. The public sector deficit should equal 1.4% of GDP in 2007 and 2008.

## ¶10. Statistical Annex

Austrian Economic Indicators  
(percent change from previous year,  
unless otherwise stated)

	WIFO project. 2007	IHS project. 2007	WIFO project. 2008	IHS project. 2008
Real terms:				
GDP	2.7	2.6	2.3	2.4
Manufacturing	5.0	n/a	3.0	n/a
Private consumption	2.1	2.2	2.0	2.1
Public consumption	1.6	1.0	1.6	1.0
Investment	4.9	4.4	3.4	2.9
Exports of goods	7.8	7.8	6.8	7.3
Imports of goods	8.2	6.7	6.8	6.6

Nominal Euro billion  
equivalents:

GDP	267.2	267.1	277.8	277.8
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Other indices:

GDP deflator	1.7	1.7	1.7	1.6
Consumer prices	1.6	1.5	1.7	1.6
Unemployment rate	4.6	4.5	4.5	4.5
Current account (in percent of GDP)	1.8	n/a	1.9	n/a
Exchange rate for US\$ 1.00 in Euro	0.74	0.77	0.70	0.77

McCaw